ERS Report Summary

Economic Research Service | April 2011 | U.S. Department of Agriculture

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Reciprocal Trade Agreements

Impacts on Bilateral Trade Expansion and Contraction in the World Agricultural Marketplace

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What Is the Issue?

Countries use bilateral/regional trade agreements to increase market access and expand trade in foreign markets. These agreements are called reciprocal trade agreements (RTAs) because members grant special advantages to each other. RTAs include many types of agreements, such as preferential arrangements, free trade agreements, customs unions, and common markets, in which members agree to open their markets to each other's exports by lowering trade barriers. They have become an increasingly prominent feature of the multilateral trading system in recent years, in part, because of stalled global negotiations taking place under the auspices of the World Trade Organization (WTO).

Many observers believe that RTAs deepen market integration and complement efforts by the WTO to liberalize international markets. While acknowledging that RTAs can open up markets, other observers contend that these agreements also distort trade and discriminate against nonmember countries.

Many studies have examined the degree to which RTAs increase trade between member countries. Relatively few, however, have attempted to quantify the extent to which RTAs curtail trade between member and nonmember countries. In this study, ERS empirically examines the bilateral trade expansion/contraction effects of RTAs in the world agricultural marketplace.

What Did the Study Find?

- Model results estimate that RTA membership boosts agricultural trade between member countries, on average, between 34 and 93 percent in the long run.

- The expansion of trade between RTA members typically comes at the expense of trade with nonmember countries. Empirical results show that agricultural trade falls, on average, between 26 and 46 percent in the long run between two countries when one of them does not belong to an RTA to which the other is a member.

- The trade impacts of RTAs grow as producers and consumers adjust to policy-induced changes in market structure and as the implementing provisions of these agreements are phased in over time. Models that account for the cumulative, phase-in effects of RTAs show that, on average, agricultural trade increases 105 percent between two trading partners that belong to the same agreement in the long run but falls 49 percent between an RTA member country and a nonmember trading partner.

- RTAs boost trade in agricultural markets. The percentage increase in partner trade expansion induced by mutual RTA membership exceeds the percentage decline in partner trade characterizing asymmetric RTA membership.

- RTAs are particularly effective at expanding agricultural trade and opening markets in developing countries when both developing-country trading partners are members of the same agreement.

How Was the Study Conducted?

ERS developed econometric models to isolate the impacts of RTAs on bilateral trade in agriculture. Researchers adopted various approaches to control for the influence of the many factors affecting bilateral trade, such as the capacity of suppliers to export, the size of demand in importing countries, transaction costs, and characteristics that induce two countries to trade with each other (e.g., differences in resource endowments). The trade data deployed in model estimations included bilateral trade flows reported by UN Comtrade between 69 countries covering the 1975 to 2005 time frame.

The empirical models identified statistical regularities, controlled for the unique institutional and physical characteristics of each country pair, and allowed for dynamic pricing and RTA phase-in effects. They yielded quantitative estimates of the impacts on partner trade of mutual and asymmetric RTA membership.